Testimony of
Robert A. Levin, Sr. VP Research
New York Mercantile Exchange, Inc.
Committee on Energy and Commerce
United States House of Representatives
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Mr. Chairman and members of the Committee, my name is Bob Levin and I am the Senior Vice President of Research at the New York Mercantile Exchange (NYMEX or Exchange). NYMEX is the world's largest forum for trading and clearing physical-commodity based futures contracts, including energy and metals products. We have been in the business for 135 years and are a federally chartered marketplace, fully regulated by the Commodity Futures Trading Commission (CFTC) both as a contract market and as a clearing organization. On behalf of the Exchange, its Board of Directors and shareholders, I thank you and the members of the Committee for the opportunity to participate in today's hearing on the futures market and gasoline prices.

INTRODUCTION

NYMEX provides an important economic benefit to the public by facilitating competitive price discovery and hedging. As the benchmark for energy prices around the world, trading on NYMEX is transparent, open and competitive and heavily regulated. Contrary to some beliefs, NYMEX does not set prices for commodities trading on the exchange. NYMEX does not trade in the market or otherwise hold any market positions in any of its listed contracts and, being price neutral, does not influence price movement.

Instead, NYMEX provides trading forums that are structured as pure auction markets for traders to come together and execute trades at competitively determined prices that best reflect what market participants think prices will be in the future, given today's information.

There is a strong beneficial and interdependent relationship between the futures and the underlying physical commodity or "cash" markets. The primary motivation for using the futures market is to hedge against price risk in the cash market. Price volatility drives many into the futures markets. Many prudent business managers rely on the futures market to protect their business against price swings in the cash market.

Futures markets provide a reference point for use in executing off-exchange trades at competitively determined prices. An understanding of the NYMEX market, its pricing mechanism and the relationship between the futures price and the cash price will provide useful instruction and clarity to what is often perceived as an esoteric area of the broader financial marketplace.

OVERVIEW

Futures markets fulfill two primary functions: (1) They permit hedging, giving market participants the ability to shift price risk to others who have inverse risk profiles or who are willing to assume that risk for potential profit; and (2) They facilitate price discovery and market transparency. Transparency involves many factors, including: (1) continuous price reporting during the trading session that is disseminated on a real-time basis worldwide by various market data vendors; (2) daily reporting of trading volume and open interest; and (3) monthly reporting of deliveries against the futures contract.

NYMEX's futures and options contracts are listed and traded by calendar month. For energy contracts, trading terminates in the month preceding the month of actual delivery of the underlying commodity (if positions are not offset and instead are held through the termination of trading for that contract month). Consequently, the front or spot month listed for trading during most of the month of May would be the June 2006 contract month. The daily settlement price for each contract month of a listed contract is calculated pursuant to Exchange rules. The rules governing the calculation of our settlement price reflect the business judgments exercised by Exchange officials.

By listing contract months for trading out into the future, a common convention in the futures industry, our prices at all times reflect the collective consensus of the marketplace as to the future direction of commodity prices. By contrast, many cash markets of the underlying commodities for our products, such as for gasoline, are quoted and traded in the cash market as day-ahead products. Consequently, there can be at times significant differences between futures prices on our markets and prices in the day-ahead cash market.

NYMEX energy futures markets are highly liquid and transparent, representing the views and expectations of a wide variety of participants from every sector of the energy marketplace. Customers from around the globe can place buy and sell orders through brokers on the NYMEX trading floor. On behalf of the customers, buyers announce their bids and sellers announce offers. The price agreed upon for sale of any futures contract trade is immediately transmitted to the Exchange's electronic price reporting system and to the news wires and information vendors who inform the world of accurate futures prices.

Price signals are the most efficient transmitters of economic information, telling us when supplies are short or in surplus, when demand is robust or wanting, or when we should take notice of longer-term trends. NYMEX futures markets are the messengers carrying this information from the energy industry to the public. The wide dissemination of futures prices generates competition in the establishment of current cash values for commodities.

Price Discovery

The institutional setting of futures trading helps discover the competitive price which best represents what the market thinks prices should be in the future, given today's information. As such, futures markets provide reference points for use in buying and selling commodities at competitively determined prices. The widespread dissemination of exchange-generated prices fosters competition in the establishment of current cash values for commodities. Because of the liquidity and transparency of the futures market, the marketplace uses the futures price to provide the reference for setting prices in the cash market. This is referred to as the "price discovery" function.

Relationship between Futures Prices and Underlying Cash Prices

Futures markets are a derivative of the cash market and are designed to ensure that the cash and futures market prices converge to a single price at expiration of the futures contract. The cash market typically consists of a variety of transactions that differ in the timing, location and form of delivery (as well as in other important commercial terms and conditions). In many cases, the general terms governing these transactions are standardized which results in development of a series of fundamental products or commodities for the underlying market. In the oil market, historically, there have been a

number of specific transaction types serving in this role. Generally, market competition results in arbitrage by market participants between these commodity-types of transactions and other less-standardized transactions such that fairly reliable statistical correlations develop between different types of products. Futures contracts are expressly designed to either correspond to an existing cash-market "standard" product or fill that role on its own.

Although futures and all cash prices often do not always move in parallel, there is considerable support for the proposition that price changes in one part of the market, cash or futures, are frequently transmitted to other parts of the market and result in similar changes elsewhere. The futures markets, therefore, reflect cash market prices and, as a result, are able to be used as a hedging vehicle. The difference between the cash and futures price at any time is known as the "basis." Usually, basis is measured as the differential between the cash price and the nearby futures price. The size of the differential provides a benchmark against which the closeout prices of both the cash and futures positions may be measured. Historically, NYMEX futures have proven to be extremely reliable vehicles for converging to the cash market; a marketplace that consistently has performed with integrity.

MARKET ANALYSIS

NYMEX staff monitors the supply and demand fundamentals in the underlying cash market to ensure that NYMEX futures prices are consistent with broad, ongoing, cash market price movements and that there are no price distortions. Our analysis of the market has identified three key factors that are contributing to higher gasoline prices in

the cash and futures market: 1) high crude oil prices; 2) methyl tertiary butyl ether (MTBE) phase-out; and 3) reduced refinery utilization rates.

High Crude Oil Prices

NYMEX trades light sweet crude oil futures contracts, one of our most actively traded energy products. Crude oil is a strategic commodity that responds to global political tensions, particularly in the Middle East and West Africa. In fact, crude oil prices are determined in a global market place. That global market place is highly sensitive to geopolitical events, and the price of crude oil responds immediately.

For example, recently, the Iranian nuclear threat appears to have contributed to price volatility as the market responds to the latest political developments. For example, on April 10, the May NYMEX crude oil futures price increased $1.35 per barrel to $68.74 at the same time that there was a headline story about Iran and the potential for a military response. Two weeks later, on April 21, the NYMEX June futures price reached an all-time high of over $75.00 coinciding with continued concerns about Middle East security and reports of Nigerian supply cuts arising from militant attacks. During this same time period, there has also been reduced production in other oil producing countries due to political unrest. Chart A (attached) reflects global crude oil prices using the front month NYMEX Light Sweet Crude Oil (WTI) futures and Brent Crude Oil futures prices.

Crude oil is the main feedstock for gasoline production and, consequently, crude oil prices can have a very strong influence on gasoline prices. As such, the strength in crude oil prices has been an important factor leading to higher gasoline prices.

Gasoline is the largest refined product by volume sold in the United States and accounts for almost half of the national oil consumption. It is a highly diverse market,

with hundreds of wholesale distributors and thousands of retail outlets, often making it subject to intense competition and price volatility.

NYMEX trades New York Harbor unleaded gasoline futures contracts. Market conditions in the gasoline market reflect the basic market fundamentals such as imbalance between supply and demand. Tight gasoline supplies due to lack of refinery capacity, compounded by the lingering impact of Hurricane Katrina, and, more recently, the transition from MTBE to ethanol have driven prices upward dramatically in the cash and futures market.

MTBE Phase-Out

The gasoline market is currently in a difficult transition period due to the phase-out of MTBE, and the related transition to ethanol. As companies eliminate the use of MTBE and replace it with ethanol, gasoline refiners and importers must adjust their practices and systems. Ethanol, which is chemically different than MTBE, contains more volatile compounds than MTBE and, therefore, is harder to use in reformulated gasoline in the summertime. In addition, ethanol cannot be carried in the nation's pipeline system, and must be segregated from the wholesale distribution system until its addition at the truck rack. Finally, ethanol presents new demand and supply implications, which must be factored into the pricing of gasoline.

There is a level of uncertainty involved in this transition process as the marketplace adjusts to the new supply situation. This uncertainty typically leads to higher gasoline prices in the short term. Buyers and sellers have concerns about demand and supply fundamentals, and the higher costs are then passed on to consumers. The transition process is now well underway but not yet completed, as the gasoline market

begins to phase out MTBE-blended gasoline. Most energy firms likely will continue to draw down and use up their reformulated gasoline (RFG) inventory during the remainder of the month of May. Market observers continue to believe that sometime this summer the Reformulated Gasoline Blendstock (RBOB) product will largely replace reformulated gasoline as the predominant gasoline product in the cash market.

Chart B, attached, shows the wholesale price of ethanol and MTBE in the New York Harbor area. As you can see, ethanol prices are currently $1.00 per gallon higher than MTBE. This large price differential indicates the strength of ethanol demand as compared to MTBE. The ethanol is then added to RBOB to make finished gasoline. NYMEX first listed RBOB gasoline futures for trading last October in anticipation of the phase-out of MTBE from the gasoline pool. Chart C, attached, shows recent prices for finished RFG (with MTBE included) and RBOB (before the addition of ethanol). The current RBOB price is about 10 cents per gallon higher than finished RFG (with MTBE), and when the ethanol is added (at a 10% blend by volume) the finished ethanol-blended gasoline recently has been priced even higher, at 15 cents higher than RFG with MTBE. This accounts for some of the recent price rise in gasoline.

Reduced Refinery Utilization Rates

Gasoline prices have been supported recently by lower refinery utilization rates due to increased refinery maintenance this spring. Some refineries reportedly had delayed maintenance work in the aftermath of Hurricane Katrina to ensure adequate gasoline supplies. Furthermore, additional refinery work is needed this year to comply with new low-sulfur requirements in diesel and gasoline. The end result is tighter

gasoline supplies in the short-term until the higher refinery utilization rates can be restored.

Even though no new gasoline refineries have been built in the U.S. in several decades, this imbalance has been mitigated to some extent by higher efficiencies from existing plants, which have generally operated at a high rate of utilization in recent years. However, such a high utilization rate also means that when utilization rates are reduced for any reason, there will be an immediate impact on the availability of new supplies of gasoline.

In the face of these market factors, the NYMEX system continues to work according to design. As intended, NYMEX's highly transparent, open and competitive market place adds a level of economic stability to the situation by providing a reliable and well-regulated price discovery and risk management forum.

CONCLUSION

At all times during periods of extreme uncertainty in the market, NYMEX has been the source for transparent prices in the energy markets. Our price reporting systems, which provide information to the world's vendors, have worked flawlessly and without delay.

The NYMEX marketplace continues to perform its responsibility to provide regulated forums that ensure open, competitive and transparent energy pricing. We can only imagine the market uncertainty and further devastation to consumers if NYMEX were unable to perform its duty and prices were determined behind closed doors.

I thank you for the opportunity to share the viewpoint of the New York Mercantile Exchange with you today. I will be happy to answer any questions members of the Committee may have.

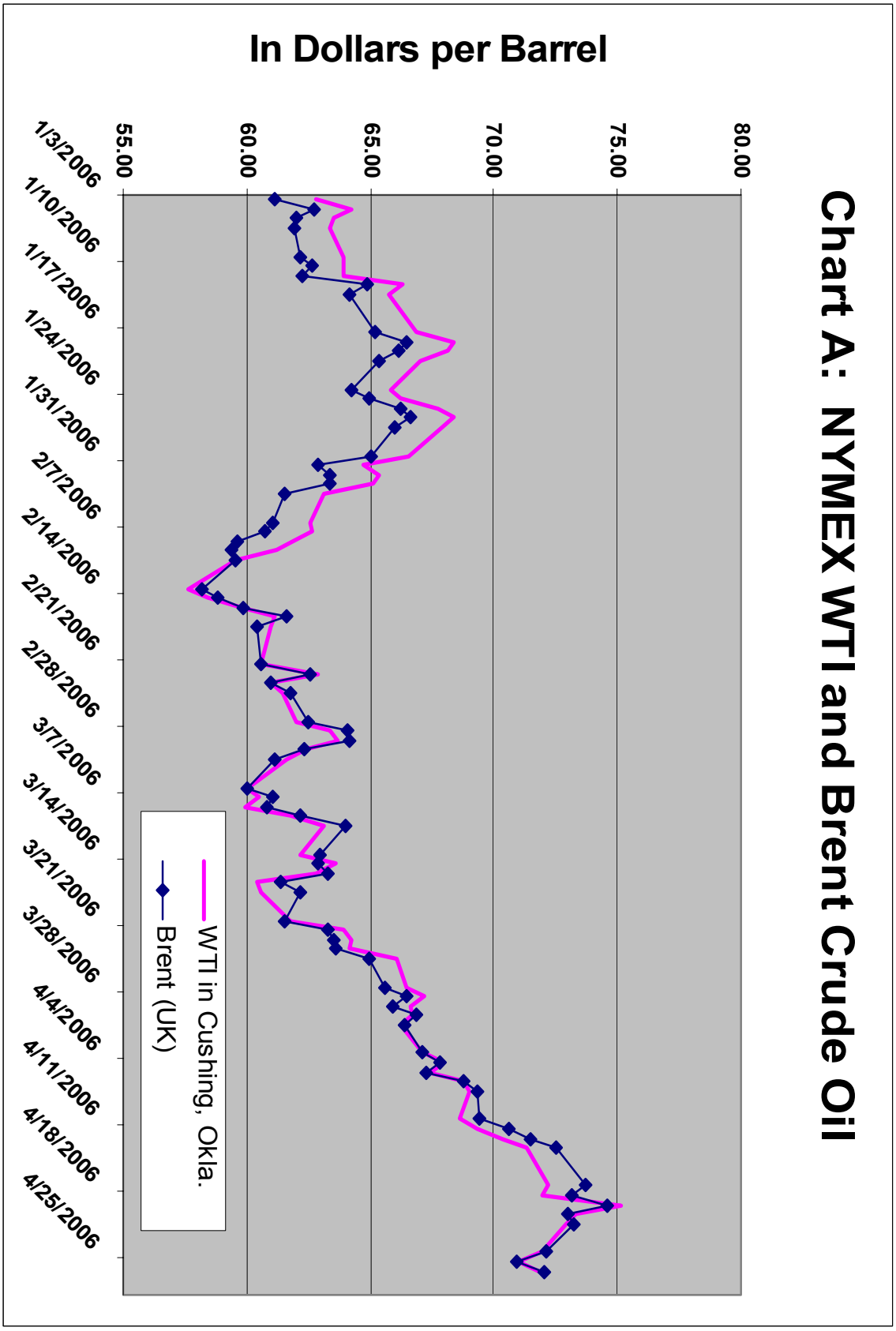
Chart A: NYMEX WTI and Brent Crude Oil
In Dollars per Barrel
80.00
75.00
70.00
65.00
60.00
55.00
1/3/2006
1/10/2006
1/17/2006
1/24/2006
1/31/2006
2/7/2006
2/14/2006
2/21/2006
2/28/2006
3/7/2006
3/14/2006
3/21/2006
3/28/2006
4/4/2006
4/11/2006
4/18/2006
4/25/2006
WTI in Cushing, Okla.
Brent (UK)

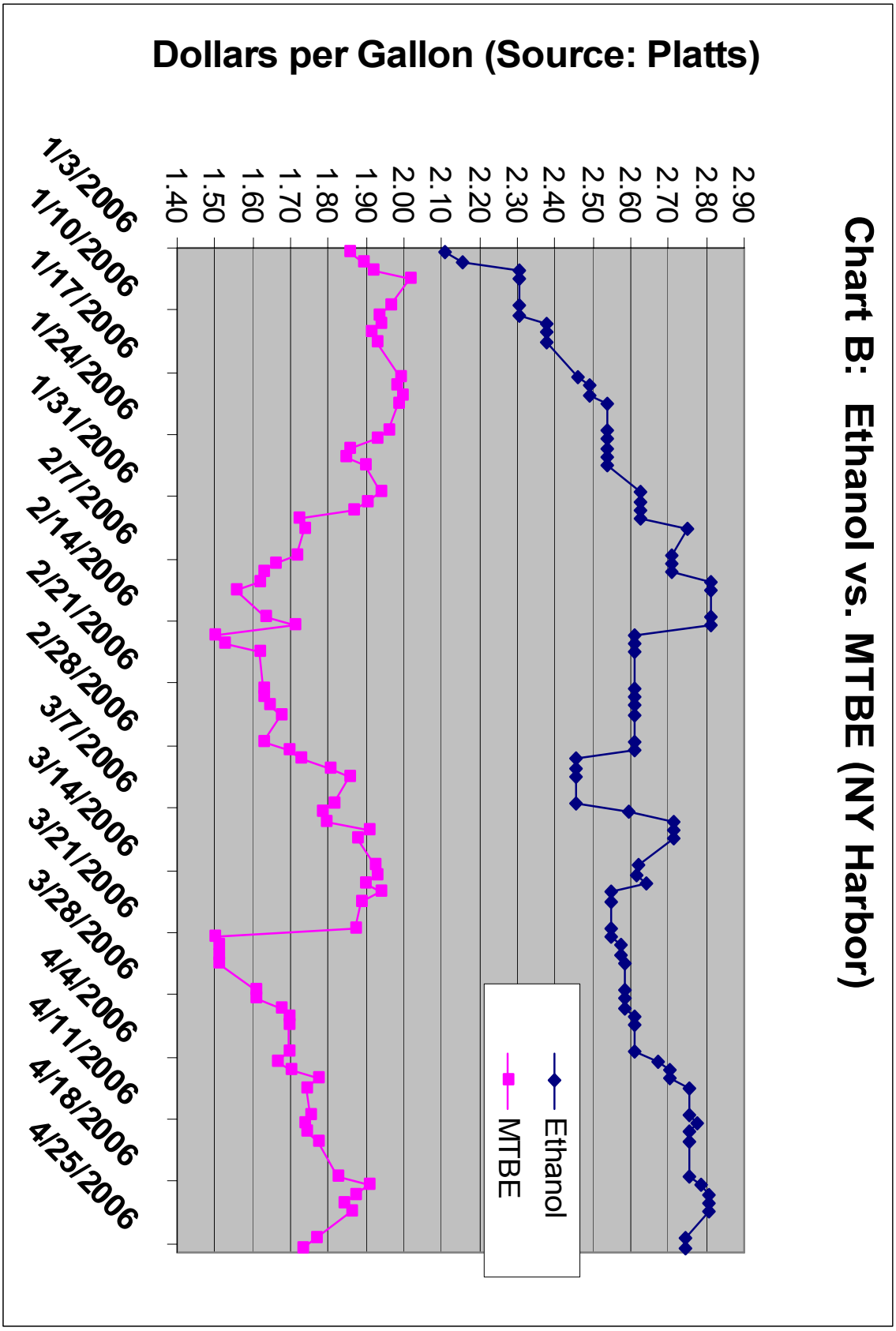
Chart B: Ethanol vs. MTBE (NY Harbor)
Dollars per Gallon (Source: Platts)
2.90
2.80
2.70
2.60
2.50
2.40
2.30
2.20
2.10
2.00
1.90
1.80
1.70
1.60
1.50
1.40
1/3/2006
1/10/2006
1/17/2006
1/24/2006
1/31/2006
2/7/2006
2/14/2006
2/21/2006
2/28/2006
3/7/2006
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4/11/2006
4/18/2006
4/25/2006
Ethanol
MTBE

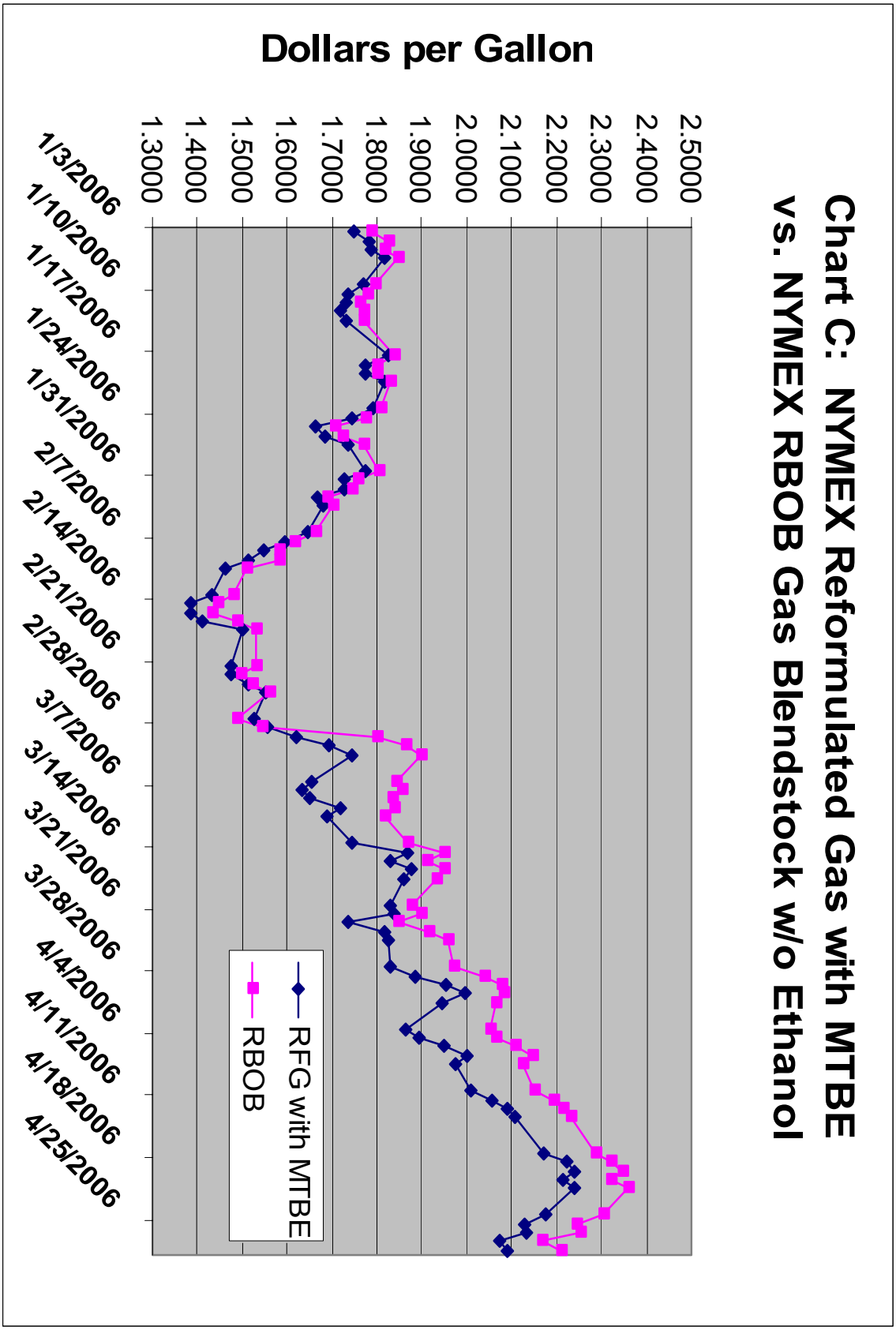
Chart C: NYMEX Reformulated Gas with MTBE
vs. NYMEX RBOB Gas Blendstock w/o Ethanol
Dollars per Gallon
2.5000
2.4000
2.3000
2.2000
2.1000
2.0000
1.9000
1.8000
1.7000
1.6000
1.5000
1.4000
1.3000
1/3/2006
1/10/2006
1/17/2006
1/24/2006
1/31/2006
2/7/2006
2/14/2006
2/21/2006
2/28/2006
3/7/2006
3/14/2006
3/21/2006
3/28/2006
4/4/2006
4/11/2006
4/18/2006
4/25/2006
RFG with MTBE
RBOB

Robert A Levin
Senior Vice President, Research
New York Mercantile Exchange

ROBERT A. LEVIN is the Senior Vice President of Research, and has held this position since 1993. He is responsible for the development and maintenance of the Exchange's business planning. Mr. Levin has been active in the development, maintenance, and refurbishing of all of the Exchange's energy contracts.

Mr. Levin has been among the major participants in restructuring proceedings governing the electric utility industry both at the state and federal levels. He represents the Exchange on advisory panels for the National Petroleum Council that study key industry issues. Mr. Levin was the Exchange's Vice President of Product Development from 1991 until 1993, and has been with the Exchange since 1987. Mr. Levin has a doctorate in economics from the University of New Mexico.